UCO BANK

v.

HSBC BANK (MALAYSIA) BHD

HIGH COURT MALAYA, KUALA LUMPUR
BADARIAH SAHAMID JC
[SUIT NO: D3-22-936-2001]
24 JUNE 2009

BANKING: *Banks and banking business - Bank drafts - Wrongfully debiting plaintiff's account with unauthorized bank drafts - Whether bank drafts paid without mandate of plaintiff - Whether alterations to bank drafts apparent - Whether defendant 'a holder in due course' - Whether plaintiff had taken 'reasonable and usual or ordinary precautions' not to facilitate alteration - Whether there was basis to impose higher standard of duty of care to plaintiff - Bills of Exchange Act 1949, s. 64(1) & (2)*

The plaintiff was a bank with its headquarters in India, and carrying on business at *inter alia* in Singapore. The defendant was a bank incorporated in Malaysia. The plaintiff maintained an account with the defendant in Malaysia, upon which the plaintiff from time to time drew, in relation to bank drafts issued by the plaintiff upon the application of its customers. Between September to October 1997, the plaintiff issued 15 bank drafts ('said bank drafts') drawn on its account with the defendant. Upon presentation of the said bank drafts, the defendant honoured the said bank drafts and debited the plaintiff's account with the amount of the payments. The plaintiff claimed that the said bank drafts were unauthorised and thus the defendant had wrongfully debited the plaintiff's account and requested the defendant to reverse the debits. The issues to be tried were (1)(a) whether the bank drafts were forged, or altered without the authority of the plaintiff and paid without the mandate of the plaintiff; (b) whether the alterations to the said bank drafts were apparent on the face of the same; (c) whether the defendant was a 'holder in due course' within the meaning of s. 64(2) of the Bills of Exchange Act 1949 ('BEA'); (2) whether the alteration of the said bank drafts by unauthorised parties were facilitated by the plaintiff's breach of duty to the defendant to take reasonable care, and if so, whether the defendant was entitled to set up an estoppel

against the plaintiff's claim; (3) whether a more onerous duty should be imposed on a 'sophisticated bank' like the plaintiff in contrast to customers who were 'laymen'; (4) whether the plaintif had breached its duty of care to the defendant by its failure to inform the defendant promptly of the alterations to the said drafts; (5) whether there was a duty on the customer to check and verify any discrepancies in the customers' account.

Held (allowing plaintiff's claim):

(1) Section 64(1) of BEA establishes the general principle that an instrument that has been materially altered without the assent of parties liable on the bill is void, except as against the party who has himself made, authorised or assented to the alteration, and subsequent indorsers. Pursuant to s. 64(2) of BEA, the alteration of the name of the payee as well as the sum in amount and figures in the said bank drafts would amount to a 'material alteration'. Thus, it would appear that the said bank drafts were void instruments and the defendant's payment in resepect of them was payment made in breach of the plaintiff's mandate. (paras 11 & 12)

(1a) The testimonies of DWS1 and DWS3 were that they sighted the bank drafts and did not notice any discrepancies on the bank drafts. This was confirmed by the expert witnesses of both the plaintiff and the defendant that the alterations would only be visible when examined by using a 'high powered stereoscopic microscope with the use of special photographs techniques' or 'a microscope with a bright white light source'. Thus, the alterations on the said bank drafts were not apparent. (para 16)

(1b) The defendant's role was that of a drawee *ie*, the party who was obliged to make the payment in accordance with the terms of the said drafts. As the drawee bank, the defendant did not even come within the definition of a 'holder' and thus it was not neccessary to consider if the defendant had succeeded in fulfilling the additional prerequisites of a 'holder in due course'. (para 19)

(2) In this case, the defendant alleged that the plaintiff was negligent in drawing the said bank drafts in that they had used an electric typewriter to type the words and figures in

the drafts. It was the defendant's argument that had the plaintiff use a pin point or dot matrix printer or typewriter instead, the alterations would have been more difficult to effect as well as easier to detect. The duty imposed on a drawer was to take 'reasonable and usual or ordinary precautions' so as not to facilitate forgery or alteration. What was usual or ordinary was not static but may evolve with time, depending in the circumstances of the case and in particular, current practice. In the absence of evidence that the current practice was to use a pin point or dot matrix typewriter instead of an electric typewriter as a reasonable and ordinary or usual precaution against the tampering of drafts, this court was unable to agree with the defendant's submission on this point. (para 31)

(3) There was no basis to impose a higher standard of duty of care to the plaintiff on the premise that the plaintiff, though a customer, was a sophisticated bank. To impose differing standards of duties according to the status of the customer would lead to uncertainty. This was inconsistent with the clear rules developed by the law merchant in the governance of negotiable instruments. (para 35)

(4) It was not seriously disputed that the plaintiff had promptly notified the defendant when it became aware, on reconciliation of its accounts, of the discrepancies arising from payment on the altered drafts. Thus, as far as the duty laid down in the case of *Greenwood v. Martins Bank Ltd* was concerned, there was no breach of duty by the plaintiff. (para 39)

(5) Nowhere was there expressly stated that the plaintiff was obligated to verify their accounts within a stipulated period and inform the defendant of any discrepancies if any. This undoubtedly fell far short of 'the undoubtedly rigorous test' to be complied before a duty to verify accounts could be imposed on the plaintiff customer. (para 46)

Case(s) referred to:

Canadian Pacific Hotels Ltd v. Bank of Montreal [1987] 40 DLR, 385 ***(refd)***

Colonial Bank of Australiasia v. Marshall [1906] AC 559 ***(refd)***

Greenwood v. Martins Bank Ltd [1932] 1 KB 371 ***(refd)***

Importers Company Limited v. Westminster Bank Limited [1927] 2 KB 297 ***(refd)***
Kepitigalla Rubber Estate Ltd v. National Bank of India Ltd [1909] 2 KB 1010 ***(refd)***
London Joint Stock Bank v. McMillan & Arthur [1918] AC 77 ***(refd)***
Slingsby v. District Bank Ltd [1932] 1 KB 544 ***(refd)***
Tai Hing Cotton Mill Ltd v. Liu Chong Hing Bank [1985] 2 All ER 947 ***(refd)***
Ung Eng Huat & Anor v Arab-Malaysian Bank Bhd [2003] 3 CLJ 624 HC ***(refd)***
Young v. Grote 4 Bing 253, Scholdfield v. Londesborough [1896] AC 514 ***(refd)***

Legislation referred to:
Bills of Exchange Act 1949, ss. 2, 29, 64(1), (2)

For the plaintiff - M/s Shook Lin & Bok
For the defendant - M/s Shearn Delamore & Co

Reported by Suhainah Wahiduddin

JUDGMENT

Badariah Sahamid JC:

Brief Background Facts

[1] The plaintiff is a bank with its headquarters in India, and carrying on business at *inter alia*, Bharat Building, 3 Raffles Place, Singapore. The defendant is a bank incorporated in Malaysia.

[2] The plaintiff maintains an account with the defendant in Malaysia, upon which the plaintiff from time to time draws, in relation to bank drafts issued by the plaintiff upon the application of its customers.

[3] Between September - October 1997 the plaintiff issued 15 bank drafts ('said bank drafts') drawn on its account with the defendant. Upon presentation of the said bank drafts, the defendant honoured the said bank drafts and debited the plaintiff's account with the amount of the payments.

Plaintiff's Claim

[4] The plaintiff claims that the said bank drafts were unauthorized and thus the defendant had wrongfully debited the plaintiff's account and requested the defendant to reverse the debits.

[5] On the failure of the defendant to do so, the plaintiff claim's *inter alia* as follows:

a) A declaration that the defendant has wrongly debited the plaintiffs' account in the sum of RM363,015.69.

b) An order that the defendant reverse the debits within seven days of the date of order.

c) Interest at 8% p.a. from the respective dates of debit of sums until date of reversal of debits or payment of sums.

Issues To Be Tried

A: Forgery/alteration of drafts

1. Whether the said bank drafts purportedly issued by the plaintiff and paid by the defendant were issued by the plaintiff, or whether they were forged, or altered without the authority of the plaintiff and paid without the mandate of the plaintiff?

2. Whether the alterations to the said bank drafts were apparent on the face of the same?

3. Whether the defendant was a 'holder in due course' within the meaning of s. 64(2) of the Bills of Exchange Act, 1949? (hereinafter referred to as BEA)

B. Breach of Duty/Negligence

4. If the said bank drafts were forged or altered, whether such forgery or alteration was facilitated by the negligence and/or breach by the plaintiff of its duties as a customer of the defendant.

5. Whether the plaintiff had failed to inform the defendant promptly of the alleged discrepancies, alterations and/or forgeries in respect of the said bank drafts?

6. Whether the defendant was entitled to debit the plaintiff's account for the sum of RM363,015.69 as claimed by the plaintiff?

Decision

[6] This case involves a recurrent theme in the area of negotiable instruments - which of two relatively innocent parties should bear the loss from the wrongful act of a third party?

[7] After careful consideration of evidence adduced at trial, parties' submissions as well as relevant authorities, I allow the plaintiff's claim against the defendant in encl. 1 with costs.

[8] The grounds of my decision are as follows.

On Issue Of Forgery/Material Alteration

Material Alteration

[9] At the trial, both the plaintiff's as well as the defendant's expert witnesses (PW2 and DWS2 respectively) confirmed that the said bank drafts were the original drafts issued by the plaintiff, and that the signatures appearing on the drafts were the signatures of the plaintiff's authorised signatories. However, the names of the payees as well as the sum in words and in figures had been altered by unauthorised third parties before they were presented to the defendant for payment.

[10] Therefore I will proceed on the basis that the said bank drafts were the original bank drafts issued by the plaintiff, but in which there were alterations of the names of payees and the sum in words and figures.

[11] Section 64(1) of BEA establishes the general principle that an instrument that has been materially altered without the assent of parties liable on the bill is void, except as against the party who has himself made, authorised or assented to the alteration, and subsequent indorsers.

[12] Pursuant to s. 64(2) of BEA, the alteration of the name of the payee as well as the sum in amount and figures in the said bank drafts would amount to a 'material alteration'. Thus it would appear that the said bank drafts are void instruments and the defendant's payment in respect of them is payment made in breach of the plaintiff's mandate.

Defence

[13] The proviso to s. 64 however affords the defendant a defence on satisfaction of the following prerequisites:

(i) the bill has been materially altered

(ii) the alteration is not apparent

(iii) the bill is in the hands of a 'holder in due course'.

[14] It is not disputed that the bank drafts in question had been materially altered, thus satisfying the first prerequisite. A

[15] I turn now to the second prerequisite. Authorities have laid down that an alteration is apparent if it is discoverable by mere sight, without the aid of special devices or instruments. In *Ung Eng Huat & Anor v. Arab-Malaysian Bank Bhd* [2003] 3 CLJ 624 at p. 635, Suriyadi Halim Omar J (as he then was) said: B

> I am satisfied that "apparent" must mean that the material alteration in the bill is discoverable by simple inspection by the holder due to its obviousness. To arrive at that finding the holder is only aided by mere sight and without the necessity of resorting to other gadgets or means to confirm that alteration. C

[16] The testimonies of DWS1 and DWS3 were that they sighted the bank drafts and did not notice any discrepancies on the bank drafts. This is confirmed by the expert witnesses of both the plaintiff and the defendant that the alterations would only be visible when examined by using a "high powered stereoscopic microscope with the use of special photographs techniques" (p. 10 DWS2) or "a microscope with a bright white light source" (p. 7 of PW2). Thus, the alterations on the said bank drafts were not apparent. This satisfies the second prerequisite. D E

[17] The third prerequisite is satisfied if the defendant is a 'holder in due course'. F

> Section 29 of BEA defines a 'holder in due course' thus:
>
> (1) A holder in due course is a holder who has taken a bill, complete and regular on the face of it, under the following conditions, namely: G
>
> a) that he became the holder of it before it was overdue, and without notice that it has been previously dishonoured, if such was the fact;
>
> b) that he took the bill in good faith and for value, and that at the time the bill was negotiated to him, he had no notice of any defect in the title of the persons who negotiated it. H

[18] To qualify as a 'holder in due course' in order to take advantage of the defence in the proviso to s. 64(1) the defendant must first be a 'holder'. Section 2 of BEA defines a 'holder' as "the payee or indorsee of a bill or note who is in possession of it I

or the bearer thereof". The payee is the beneficiary of the instrument, which obviously the defendant is not. In the alternative, to qualify as an indorsee the defendant must have had the said bank drafts negotiated to the defendant ie, transferred to the defendant by indorsement. No such indorsement took place. Moreover, since the said bank drafts are not bearer instruments, the mere delivery of the instruments to the defendant would not amount to an indorsement of said drafts. Thus, it is clear that the defendant is neither a payee nor an indorsee of the said drafts.

[19] The defendant's role is that of a drawee ie, the party who is obliged to make the payment in accordance with the terms of the said drafts. As the drawee bank, the defendant does not even come within the definition of a 'holder' and thus it is not necessary to consider if the defendant has succeeded in fulfilling the additional prerequisites of a 'holder in due course' stipulated by s. 29 of BEA.

[20] Therefore the defence afforded by the proviso to s. 64 of BEA to a 'holder in due course' is not applicable to the defendant.

Issue Of Breach Of Duty/Negligence

[21] The next issue to be considered is whether the alteration of the said bank drafts by unauthorized parties was facilitated by the plaintiff's breach of duty to the defendant to take reasonable care, and if so, whether the defendant is entitled to set up an estoppel against the plaintiff's claim?

[22] Although both parties here are banks, due to the nature of the transactions between them, their relationship is that of a banker and customer with the attendant obligations laid down by judicial authorities. *Importers Company Limited v. Westminster Bank Limited* [1927] 2 KB 297.

[23] In *London Joint Stock Bank v. McMillan & Arthur* [1918] AC 77, the House of Lords laid down that the relationship of banker and customer imposed a special duty on the customer in drawing an instrument to take reasonable and ordinary precautions against any alteration of the instrument. However, the court restricted the negligence to the failure to take reasonable and ordinary precautions in the drawing of the instrument.

[24] According to Lord Finlay LC:

> if he draws a cheque in a manner which facilitates fraud, he is guilty of a breach of duty as between himself and the banker, and he will be responsible to the bank for any loss sustained by the bank as a natural and direct consequence of the breach of duty …

[25] In *McMillan*'s case the finding of negligence was premised on the following facts:

> He (the customer) signed the cheque, leaving entirely blank the space where the amount should have been stated in words, and where it should have been stated in figures there was only the figure '2' with blank spaces on either side of it. In my judgement, there was a clear breach of the duty which the customer owed to the banker.

[26] The judicial trend is thus far to find negligence in the drawing of the instruments where the instrument is filled up leaving spaces or interpolations that facilitate tampering. *Young v. Grote 4 Bing 253, Scholdfield v. Londesborough* [1896] AC 514, *Colonial Bank of Australiasia v. Marshall* [1906] AC 559.

[27] The question arises whether negligence in the drawing of instruments are necessarily confined to the above mentioned only?

[28] Interestingly, in the case of *Slingsby v. District Bank Ltd* [1932] 1 KB 544 it was argued that the drawers of a cheque had been negligent in not drawing a line after the payee's name and so had facilitated the alteration of the instrument. The Court of Appeal rejected the contention on the ground that it was not at that time a 'usual precaution' to draw lines before or after the drawee's name; Scrutton L.J. noted (at p. 560) that if cases of such nature became frequent, it might become a 'usual precaution'.

[29] It would seem therefore that what is material is whether in drawing the instrument the drawer had taken reasonable and ordinary or usual precautions according to the circumstances of the case.

[30] In this case before me the defendant alleges that the plaintiff was negligent in drawing the said bank drafts in that they had used an electric typewriter to type the words and figures in the

drafts. The defendant's argue that had the plaintiff used a pin point or dot matrix printer or typewriter instead, the alterations would have been more difficult to effect as well as easier to detect.

[31] The duty imposed on a drawer is to take 'reasonable and usual or ordinary precautions' so as not to facilitate forgery or alteration. What is usual or ordinary is not static but may evolve with time, depending on the circumstances of the case and in particular, current practice. In the absence of evidence that the current practice is to use a pin point or dot matrix typewriter instead of an electric typewriter as a reasonable and ordinary or usual precaution against the tampering of drafts, I am unable to agree with the defendant's submission on this point. To hold otherwise would mean that all drafts, bills cheques would have to be 'written' using a pin point or dot matrix printer or typewriter-even in instruments drawn by individuals!

A More Onerous Duty On A Sophisticated Customer?

[32] The defendant argues that a more onerous duty should be imposed on a 'sophisticated bank' like the plaintiff in contrast to customers who are 'laymen'. As one of the ten largest banks in India, the plaintiff would be well aware of the risks of fraud and therefore is obliged to take the necessary precautions. A similar argument was raised in the case of *Canadian Pacific Hotels Ltd v. Bank of Montreal* [1987] 40 DLR, 385. In the aforementioned case, the appellant bank's daily bank statement contained the statement: "Please check this statement promptly. Any errors, irregularities or omissions found therein should be reported with 30 days of delivery or mailing, otherwise it will be considered correct."

[33] The trial judge held that as a 'sophisticated customer', the appellant corporation, Canadian Pacific Hotels Ltd. owed a duty to the respondent bank to examine its bank statements with reasonable care and report discrepancies as well as to maintain an acceptable system of internal controls for the prevention of forgeries of the cheques. A majority of the Ontario Court of Appeal upheld the judgement.

[34] However on appeal, the Supreme Court of Canada held that there was no justification for imposing different standards of duties between different categories of customers. Le Dain J stated (at p. 429):

> First I would question the attempt in the present case to limit the application of the duties affirmed, as a matter of general principle, to a particular class or category of customers characterized vaguely as 'sophisticated commercial customer'. With great respect, I do not think there is a sound basis in law for implying a duty in the banker and customer relationship with such a limitation. I agree with Cons J. A. in *Tai Hing* that such a duty, if it exists, must apply in every case of the banker and customer relationship and to all customers, whether sophisticated or not. Such a limitation or qualification, even if it were sound legally, would lead to great uncertainty.

[35] Thus there is no basis to impose a higher standard of duty of care to the plaintiff on the premise that the plaintiff, though a customer, is a sophisticated bank. To impose differing standards of duties according to the status of the customer would lead to uncertainty. This would be inconsistent with the clear rules developed by the law merchant in the governance of negotiable instruments.

Duty To Inform Bank Of Forgeries Or Alterations

[36] The next question for consideration is whether the plaintiff has breached its duty of care to the defendant by its failure to inform the defendant promptly of the alterations to the said drafts?

[37] *Greenwood v. Martins Bank Ltd* [1932] 1 KB 371 is authority for the proposition that a customer owes a duty to promptly inform the bank on discovery that cheque or draft have been forged or altered. A failure to do so by the customer would estop the customer from claiming against his banker.

[38] In this case before me, the allegation of the defendant is that during a period between 19 September 1997 to 3 November 1997, the defendant had sent SWIFT Telexes to the plaintiff on the days the plaintiff's account was debited following payment of the said bank drafts. Had the plaintiff effected prompt reconciliation of its accounts, the alterations to the said drafts

could have been discovered and the plaintiff alerted earlier. Notifications of discrepancies were only telexed by the plaintiff to the defendant on 3 November 1997 after payment had been made on the altered bank drafts.

[39] It is not seriously disputed that the plaintiff had promptly notified the defendant when it became aware, on reconciliation of its accounts of the discrepancies arising from payment on the altered drafts. Thus, as far as the duty laid down in Greenwood's case is concerned, there is no breach of duty by the plaintiff.

Duty To Effect Prompt Reconciliation Of Accounts

[40] What the defendant is alleging goes further - that the Plaintiff has a duty to effect prompt reconciliation of accounts, in other words to check and verify discrepancies in the account. Had this been done promptly, the discovery of the altered bank drafts could have been made sooner.

[41] At the trial, PW1 had confirmed in her testimony that the usual procedure is that a reconciliation of accounts based on the statements of defendant are checked at monthly intervals at the end of the month. However, a reconciliation of accounts for the month may be missed if for eg, the officer in charge goes on leave during that period.

[42] The unauthorised payments and debits to the plaintiff's account were made between 18 August 1997 and 1 November 1997. According to the testimony of PW1, the plaintiff was only aware of the unauthorized payments when it made reconciliation at around the end of October 1997 or the beginning of November 1997. The plaintiff had notified the defendant by telex dated 3 November 1997. It would appear that no reconciliation was effected for the end of August and the end of September.

[43] The issue raised above pertains to the issue of whether there is a duty on the customer to check and verify any discrepancies in the customers account?

[44] There have been attempts to widen or enlarge the customer's duty of care to include a duty to verify and inform the bank of any discrepancies in the account. *Kepitigalla Rubber Estate Ltd v. National Bank of India Ltd* [1909] 2 KB 1010. *Tai Hing Cotton Mill Ltd v. Liu Chong Hing Bank* [1985] 2 All ER 947 However, the courts have taken a very cautious stand to impose such a duty only if there exists certain prerequisites. In *Tai Hing*

Cotton Mill Ltd v. Liu Chong Hing Bank [1985] 2 All ER 947, the Privy Council laid down that as a general principle, there is no implied duty on the customer to check and verify his statement of accounts for discrepancies and to be bound to report such discrepancies to the bank within a certain time limit. Such a duty can only be imposed by express agreement between the parties, made in clear and unambiguous terms. This was referred to by Lord Scarman as an" undoubtedly rigorous test". Was there such an agreement in this case?

[45] The defendant referred to an "Agency Agreement" between the parties which imposed such a duty. The relevant clause of the said "Agency Agreement" (encl. 41 p. 18), is reproduced below:

> No advice of drawing by DD is required to be sent. Cover for demand drafts or mail payment orders in excess of USD 5,000 (or equivalent) should be sent to the relevant reimbursing agent by telex or Swift.

[46] In my opinion, the clause only lays down the requirement that the defendant send cover notification in respect of demand drafts drawn in excess of USD 5,000. It is not disputed that such telex notification was sent. Nowhere is there expressly stated that the plaintiff is obligated to verify their accounts within a stipulated period and inform the defendant of any discrepancies if any. This undoubtedly falls far short of "the undoubtedly rigorous test" to be complied before a duty to verify accounts can be imposed on the plaintiff customer.

[47] I therefore allow the plaintiff's claim against the defendant in encl. 1 with costs.